

AEO Policy Paper

ASSOCIATION FOR ENTERPRISE OPPORTUNITY • APRIL 1998

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EXECUTIVE SUMMARY

The Role, Complexities and Practice of Microenterprise in the United States

Small business is the backbone of the U.S. economy, accounting for 53.1% of all jobs. (Office of Advocacy, Small Business Administration). Though often overlooked, the smallest firms within this realm, self-employed individuals and microenterprises employing fewer than ten workers, are playing an increasingly vital role. As reported by the U.S. Small Business Administration, while firms of five to five hundred employees in all industries experienced a net loss of 2,065,000 jobs from 1989-1991, microenterprises experienced a net increase of 2,624,000 jobs. Despite their critical role, it remains virtually impossible for most microentrepreneurs to obtain the capital and management assistance they require to grow their businesses, develop new products, tap new markets, and create new jobs.

The U.S. Microenterprise Industry

The most striking feature of the U.S. microenterprise industry is its diversity. While the individuals and communities in the U.S. that need and benefit from microenterprise assistance are quite varied, most microenterprise development programs target their services to low-income people. Programs are tailored to meet the needs of specific target groups such as persistently poor individuals and individuals dependent on public assistance, women, minorities, the working poor, and individuals or business sectors who, for these and other reasons, lack access to credit. Programs may also specifically target young people, refugees, rural areas, homeless individuals, dislocated, underemployed or unemployed workers, or ex-offenders.

The goals adopted by each program depend not only on its community and target groups, but also its organizational structure. In the U.S., a wide range of institutions –including stand-alone microenterprise development organizations, community development corporations, loan funds, community action agencies, women's organizations, community development banks and credit unions, housing and social service programs, and federal, state and local government agencies – are involved in implementing microenterprise development programming. Working independently or as part of a larger organization or network, microenterprise programs pursue diverse goals that include job creation, business

and community development, poverty alleviation, human capital development, income generation, and asset development and economic self-sufficiency among women, ethnic minorities and other disadvantaged populations.

U.S. microenterprise programs have evolved many different development models that use a variety of credit, technical assistance and personal support to meet diverse goals. There are three principal program models that dominate microenterprise programs in this country.

- Credit-led individual loan programs provide loans to clients on a one-to-one basis.
- Training-led programs are based on providing substantive training and/or technical assistance to clients before offering or referring clients to credit.
- Peer lending programs provide credit to microentrepreneurs through borrower or peer groups, in which individuals come together to make group underwriting decisions, create some safeguards against default, and provide mutual support and technical assistance.

What is the Association for Enterprise Opportunity?

The Association for Enterprise Opportunity (AEO) is the national association of organizations committed to microenterprise development. We provide our members with a forum, information and a voice to promote enterprise opportunity for people and communities with limited access to economic resources.

Founded in 1991, and based in Chicago, AEO also represents the U.S. microenterprise agenda in the growing international community. Membership in AEO is open to practitioners, individuals, public agencies, funders and others who share in AEO's mission.

AEO's challenge, issued to all microenterprise supporters across the country, is to help one million low-income individuals in the U.S. to achieve self-sufficiency through self-employment by 2008. We invite participation from all sectors and welcome their support.

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AEO encourages programs of all models to address the four primary elements of comprehensive microenterprise programming:

- training and technical assistance;
- credit or access to credit;
- access to market; and
- economic literacy and asset development.

AEO recognizes that it may not be sensible or realistic for all program to offer all four elements; rather AEO suggests programs focus on that which the community needs and that which they can do best. Consultation among key community stakeholders is highly desirable and recommended before any new programming is launched.

Distinctions Between Microenterprise Development in the U.S. and Developing Nations

Though important lessons have been learned from international microenterprise models, microenterprise development programs in the U.S. have evolved to meet the unique and diverse needs of microentrepreneurs in this country. Entrepreneurs in the U.S. operate within an economic and regulatory structure that is more complex than those found in many developing countries. And yet, while the U.S. financial sector is more well-established than that of many developing countries, lending practices remain relatively conservative. Most microentrepreneurs need significant assistance in accessing capital from conventional banks and other lending institutions to grow their businesses. Since conventional sources of credit rarely provide training, U.S. microenterprise programs often emphasize business skills and technical assistance as much as or more than financial assistance. In many cases, programs identify themselves purely as technical assistance providers and their work involves helping entrepreneurs secure financing through a conventional bank or a community-based lender.

U.S. microenterprise development embraces several key points:

- Microenterprise development encompasses more than microcredit.
- Microenterprise development embraces poverty alleviation, human development, and economic development strategies.
- Microenterprise development in the U.S. is strongly affected by the complexity of the U.S. economy.
- Microenterprise development includes a variety of program models.

Factors include considerations such as the demographics of clients served, and regulatory, tax, and welfare issues. The fact that the smallest enterprises in the U.S. must compete against very large enterprises and corporations also has important implications for the design and cost structure of U.S. programs.

The Impact of Microenterprise Development

- Microbusinesses create jobs and generate profits and tax revenue.
- Microenterprise programs serve communities and individuals that are disadvantaged by race, ethnicity, gender, or socio-economic status or that otherwise lack access to credit and entrepreneurial training opportunities.
- While not necessarily providing the sole source of income, microenterprises contribute significantly to the earnings and assets of owner-operators.
- Microenterprise strategies help reduce reliance on public assistance programs.
- Microenterprise assistance provides positive non-financial, long-term benefits to microentrepreneurs and the communities in which they operate their businesses.

Public-Sector Support of Microenterprise Development Will Yield Dividends

Microenterprise support will yield its greatest value as an economic and human development strategy over the long term. Yet, after only fifteen years in existence, microenterprise programs in the U.S. are creating jobs, generating income, building assets and enhancing skills. These results are particularly impressive when one considers that a significant proportion of assisted microentrepreneurs are individuals disadvantaged by race, ethnicity, income, job market fluctuations, or location. Public-sector investment in microenterprise development will maintain and substantially increase these returns over time.

Results From the Industry

Though not a panacea for the complex problems of chronic unemployment and poverty, microenterprise development has proven itself as a viable grassroots strategy for achieving significant gains in the incomes and assets of many people left out of the economic mainstream. Consider the following evidence:

- The Institute for Social and Economic Development (ISED) in Iowa has helped more than 600 businesses start or expand. The great majority of the entrepreneurs were public assistance recipients and other low-income individuals. These businesses, 70% of which have survived for at least 3 years, have leveraged more than \$3 million in private capital. Impressive results in helping welfare-dependent individuals start businesses can also be found in such diverse settings as Chicago, San Francisco, and rural Arkansas.
- Though less than 6 years old, the ACCION U.S. program has found a giant market niche of hard-working entrepreneurs unable to find adequate management and financial assistance. Through offices in six cities, ACCION has disbursed \$5+ million to over 2,000 borrowers, predominantly minorities, women or low-income individuals. Customers have achieved impressive income and asset gains, as well as generated many jobs. Repayment rates of ACCION and high-volume microlenders serving Arizona, North Carolina, New England, Miami, Delaware, and many other parts of the U.S. have averaged well over 95%.
- A key study of established microenterprise programs reported that 40% of clients surveyed experienced increases in household earnings and 58% increased household assets. Most significantly, 56% now rely on their microbusiness as their primary source of earnings.¹
- A survey of microenterprise programs helping individuals on public assistance to start and grow microbusinesses showed that reliance on welfare as a primary source of income decreased by 65%.²
- A comprehensive internal evaluation of a U.S. Department of Labor demonstration carried out in Massachusetts to provide self-employment assistance to 600 permanently dislocated workers documented gains in annual total earnings of nearly \$6,000.

Recommendations for Federal Policy to Support Microenterprise Development

A central theme emerging from the experience of microenterprise programs is the importance of a legal and regulatory environment that nurtures rather than discourages entrepreneurship. Toward this end, the Association for Enterprise Opportunity (AEO) – in consultation with its over 500 members, representing all 50 states – has crafted the following federal policy recommendations:

- **Incorporate microenterprise development into federal economic development programs:** Ensure that self-employment options are available and microenterprise development assistance is accessible to entrepreneurs in programs that promote economic development.
- **Offer microenterprise development as an alternative to paid employment for participants in state welfare reform and federally funded welfare-to-work initiatives:** Create and encourage opportunities for public assistance recipients to pursue self-employment.
- **Integrate microenterprise development into employment and training programs:** Support entrepreneurial and business skills training for dislocated workers and other potential entrepreneurs as part of federal employment and training programs.
- **Strengthen support for microenterprise development within all federal agencies:** In order to succeed, entrepreneurs need a healthy and safe environment in which to live and work; access to affordable quality financial services, housing, medical care, education, transportation, child and elder care services, and most important, readily available community-based microenterprise development programming.
- **Promote bank partnerships:** Encourage and facilitate the support of traditional financial institutions in the growth of microbusinesses and microenterprise development programs.
- **Improve federal agency coordination:** Maintain and strengthen the federal interagency mechanism in the U.S. Treasury Department CDFI Fund to coordinate microenterprise development activities within the federal government and to help analyze methodologies, implement performance standards, and evaluate and disseminate best practices in the microenterprise industry.

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Principles to Guide Federal Policy

- Microenterprise development is a long-term investment strategy which generates both economic and human benefits.
- The diversity of program goals, clientele and program designs is a key strength of the U.S. microenterprise industry.
- Capacity-building and innovation among U.S. microenterprise programs are critical to the future effectiveness and efficiency of the industry.
- Microenterprise development is one critical component of an overall development finance system that cultivates new and emerging businesses among entrepreneurs who are underserved by conventional banking institutions.

FOOTNOTES

¹ Self-Employment Learning Project of the Aspen Institute, *Microenterprise Assistance: What Are We Learning About Results?* Washington, DC, November 1995.

² Corporation for Enterprise Development, *Building Assets: Self-Employment for Welfare Recipients — Overview of the Findings from the Self Employment Investment Demonstration*, Washington, DC, 1995.